Hershey Foods Corporation

1975 Annual Report

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Hershey Foods . . .

is the largest domestic producer of chocolate and cocoa. Its Chocolate and Confectionery Division has plants in Hershey, Pa.; Oakdale, California; and Smiths Falls, Ontario, Canada.

It has two principal subsidiaries—San Giorgio Macaroni Inc., a large regional producer of pasta products, with major plants in Lebanon, Pa., and Louisville, Ky.; and Cory Food Services Inc., Chicago-based manufacturer of coffee-brewing equipment and other appliances and provider of the nation's largest office coffee service plan.

Headquartered in Hershey, Pa., the Corporation employs 7,150 people and has 19,279 stockholders.

Hershey Foods Corporation • Hershey, PA 17003 • (717) 534-4200

1975 Highlights

	1975	1974	% Change
Net sales from continuing operations	$556,328,000	$491,995,000	+ 13.1
Income from continuing operations	$ 39,293,000	$ 24,371,000	+ 61.2
Losses from discontinued operations	$ (1,433,000)	$ (2,277,000)	+ 37.1
Loss related to disposal of discontinued operations	$ (4,898,000)	$ —	—
Net income	$ 32,962,000	$ 22,094,000	+ 49.2
Net income per common share			
Continuing operations	$3.02	$1.87	+ 61.5
Losses from discontinued operations	$(.11)	$(.17)	+ 35.3
Loss related to disposal of discontinued operations	$(.38)	—	—
Net income per common share	$2.53	$1.70	+ 48.8
Dividends per share—			
Common stock	$ .85	$ .80	+ 6.3
Preferred stock	$ .60	$ .60	—
Dividends paid	$ 10,287,948	$ 9,699,264	+ 6.1
Capital expenditures	$ 10,203,000	$ 10,887,000	− 6.3
Stockholders' equity	$195,847,000	$173,173,000	+ 13.1
Equity per common share and equivalent at year end	$15.04	$13.30	+ 13.1
Outstanding common and equivalent shares at year end	13,024,000	13,024,000	—
Outstanding common shares at year end	13,024,000	11,824,000	+ 10.1
Market prices of common stock—range during: First Quarter	$ 10⅛-17½	$ 12¼-15	
Second Quarter	$ 16½-20⅞	$ 10¼-13⅜	
Third Quarter	$ 14 -18¾	$ 8⅝-11¼	
Fourth Quarter	$ 15 -19¾	$ 8½-11	

Quarterly dividends of 20¢ per share for the first three quarters and 25¢ per share for the fourth quarter were paid on common stock in 1975 compared with 20¢ per share for 1974. Quarterly dividends of 15¢ per share were paid on the preferred stock in both years.

To Our Stockholders:

Harold S. Mohler
Chairman of the Board

THE YEAR 1975 was a good one for your Company. Hershey Foods Corporation achieved record sales from continuing operations which advanced 13% over 1974 sales levels to $556,328,000. We reached a record level of consolidated net income, which increased 49% over 1974 to $32,962,000, or $2.53 net income per common share.

During 1975 we took the opportunity to put Portion Control Industries behind us to strengthen our forward-going position, both in improved earnings and cash flow to the Company. Excluding the loss from discontinued operations of $1,433,000 and the loss resulting from the termination of operations and the sale of assets of $4,898,000, income from continuing operations was $39,293,000, or $3.02 income per common share.

We entered the year facing the problems of unprecedented high costs of major ingredients, inflationary pressures and a depressed economy. The attainment of our sales and profit has demonstrated the soundness of our marketing concepts, as well as the ability of management to cope successfully with change.

Sales of the Chocolate & Confectionery Division have reached an all-time high. All major product lines continue to show healthy growth in dollars and share of market. Most noteworthy was the success of Kit Kat brand in achieving national distribution and sales levels of major significance. This success was achieved because of a coordinated advertising, promotion and distribution program on the part of your Company and good consumer acceptance of the product.

During 1975 there was a continuing change in consumer demand from convenience foods to more in-home baking and food preparation. We were in a position to meet this challenge because of the flexibility of our marketing approach, our broad-based product line and a production capability to meet the changing demands of the market. As a result, we have continued to experience significant gains in the sales of our grocery products—syrup, cocoas, cocoa mixes, and baking chips.

Because of the continuing high level of prices, cocoa beans processed by chocolate manufacturers have decreased from the 1974 levels. Your Company has experienced a decline in the volume of cocoa beans processed, but not to the same extent as the rest of the industry. Most encouragingly, the processing of cocoa beans increased in the latter portion of 1975, in response to increased consumer demand. During this upsurge, your Company outperformed the industry.

Because of decreasing commodity ingredient costs, primarily sugar, some price reductions were made during 1975. Additional price reductions and bar weight increases were instituted in early 1976. This is in accordance with our continuing philosophy of offering the best possible value to the consumer. We are confident that these changes will have a positive impact on consumer acceptance and support the continuing demand for our products.

In the Food Products and Food Services operation, San Giorgio's brand products achieved a significant improvement in market share in the pasta industry. At the same time, operating margins increased as a result of improved management control over operations (following the merger of San Giorgio and Delmonico) and reduced ingredient costs. Although Cory Food Services was profitable, it did not achieve the planned operating margins. This was due to the effects of a general business recession, coupled with the rapid rise in the cost of coffee.

During 1975 we increased advertising expenditures to the $9,325,000 level. The consumer acceptance of our products during this period of uncertain market conditions has justified this decision. Because of our confidence in the future prospects and continuing growth of your Company,

together with our experience in 1975, we are planning further increases in our advertising expenditures in 1976.

In conjunction with our increased marketing effort, we are planning to increase our capital expenditure levels to improve and modernize our production processes and provide additional product line capacity. It is expected that our capital spending level for 1976 will be approximately $25 million, compared with $10 million in 1975.

To assure the on-going viability of the Company, in addition to increased advertising and capital expenditures referred to earlier, the resources allocated to research and development will be significantly greater in 1976. The benefits of this advanced level of spending in research and development will result in expediting the introduction of new products along with improvements in the present brands as well as more efficient processing techniques.

A very key and vital ingredient in the success of your Company in its 70-year history has been integrity of product. Recognizing the fundamental importance of this fact, management has designed and has begun installation of a system that will assure the maintenance of this tradition. The system is known as the Product Excellence Program (PEP) and will provide the Company with an efficient approach to product safety and quality control.

We take pride in our record of working cooperatively with the government regulatory agencies to assure that our consumers will receive products of consistently high quality. In concert with the government we are working in the areas of product labeling, children's advertising, environmental protection and energy conservation, as well as other issues facing our industry.

To perpetuate a strong and experienced management team which will provide leadership to your Company in the years ahead, I recommended, and on December 30, 1975, announced, the following changes in the Corporate organization. Effective March 1, 1976, William E. C. Dearden assumed the position of Vice Chairman and Chief Executive Officer. Richard A. Zimmerman assumed the position of President and Chief Operating Officer. I continue to serve as Chairman of the Board and Chairman of the Executive Committee.

As Chief Executive Officer, Mr. Dearden is responsible to the Board of Directors for all functions of the Company. As Chief Operating Officer, Mr. Zimmerman, in addition to his present responsibility for food and food-related operations, assumed responsibility for the chocolate and confectionery operations. The Chief Operating Officer reports directly to Mr. Dearden.

A concerted effort made by management to improve the financial strength of the Company resulted in an excellent financial condition—the best the Company has experienced in recent years. This provides the Company with a flexibility and liquidity to move forward. Though economic conditions remain unsettled, operating gains achieved during the past year, our strong financial position, and our confidence in our people and organization, convince us that we have a strong basis for the future growth of your Company. In recognition of this, the Board of Directors voted to increase the cash dividend on common stock 25%, to an annual rate of $1.00 per share, beginning with the December 15, 1975, dividend payment.

The accomplishments of your Company in 1975 would not have been possible without the diligent effort and dedication of the thousands of loyal and industrious employees of Hershey Foods Corporation. We thank the employees for their contribution during the year, and we are confident of their ongoing contribution to the future of our Company.

H. S. Mohler

Chairman of the Board

Reese packaging line at Hershey, Pa.

Kit Kat bar inspection at Hershey, Pa.

Kiss wrapping line at Hershey, Pa.

Chocolate and Confectionery Division

	1975	1974
Sales (in millions)	$483.4	$419.2
% Change	+15.3	
Operating Income (in millions) .	$ 80.0	$ 50.3
% Change	+59.3	

All-time highs in sales and operating income were achieved by the Chocolate & Confectionery Division in 1975. Sales levels continued to build on the momentum generated during 1974, totaling $483,426,000, a 15% increase over the strong performance in 1974. This sales growth was accompanied by a 59% increase in operating income, which reached $80,032,000, a new high. The Division exceeded the objectives established for 1975.

In response to higher levels of marketing support for existing and new products, Division brands achieved a consistent pattern of gain in market shares. As the year 1975 progressed, the Division sales gains reflected advances in unit volume.

Products

The sales growth was achieved through a combination of significant gains in established product sales, supplemented by important sales contributions from new products.

Supported by an expanded marketing effort in the form of consumer advertising, trade promotion, consumer promotion and field sales support, dollar sales increases and market share increases were recorded. Among the major confectionery brands recording share increases were Hershey's Milk Chocolate, Hershey's Milk Chocolate with Almonds, Reese's Peanut Butter Cups, Hershey's Mr. Goodbar, and Kit Kat.

Percentage increases in dollar sales growth of grocery products were at even higher levels. This growth reflected both higher selling prices and changes in con-

sumer habits in the form of increased in-home baking and in the preparation of hot and cold chocolate drinks. Significant percentage sales increases were recorded by cocoa, consumer syrup, and baking chips. In a rapidly growing water additive market, the market share of Hershey's Hot Cocoa Mix was improved significantly. Within the large milk additive market, Hershey's Instant also recorded market share increases.

New products and new pack types contributed significantly to both the sales and operating income advances. National distribution of Kit Kat was achieved in mid-1975; the brand has exceeded sales expectations and has taken its place as a major confectionery brand in the United States. Kit Kat is one of several products being marketed in the United States under agreement with Rowntree Mackintosh of York, England. Kit Kat production capacity in the United States was more than doubled during 1975 to meet the increasing consumer demand for this product.

Another new product included as part of the agreement with Rowntree Mackintosh is Rolo, a chewy toffee covered with chocolate. The success of Rolo market tests, conducted with product imported from England, led to the decision in the fall of 1975 to proceed with a major capital investment to build production capacity which will allow national distribution on this new brand. Other Rowntree Mackintosh products are currently in various stages of consumer and market tests to determine their sales and profit potential in the United States.

Chocolate Covered Raisins were introduced into test market in selected areas of the country in September, 1975. Supported by consumer advertising and a strong introduction program, this new brand has rapidly attained good levels of retail distribution. A number of other new confectionery and grocery products are in various stages of consumer testing, store testing and market testing to determine their potential in the marketplace.

Successful introduction of new products requires large capital investments to develop the production facilities and the commitment of sizable expenditures in consumer advertising and promotion which are re-

Control panel at Oakdale, Calif.

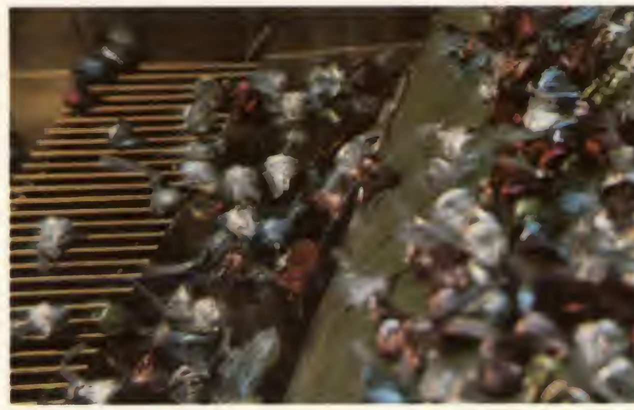
Mr. Goodbar packaging at Oakdale, Calif.

Reese packaging lines at Oakdale, Calif.

Hershey's newest product

Bar line at Smiths Falls, Canada

Almond harvest at L. D. Properties



Tumbling kisses

quired to attain national distribution and create consumer knowledge of these new products. The Division is committed to making the investment in both time and dollars required in research and development and consumer and market testing which are necessary to assure a high probability of success when new brands are introduced into the marketplace. An orderly step-by-step evaluation process for looking at potential new products increases the success rate in the marketplace and builds the confidence of our customers, encouraging them to aggressively promote those carefully selected new brands which the Division introduces.

Operating Income

Division management and employees entered 1975 faced with the challenge of controlling costs in the wake of spiraling inflation—coupled with a softening trend in total industry demand for confectionery products. Hershey people at all locations concentrated their energies on the development of new operating efficiencies designed to achieve increasing productivity in all Division plants, offices and warehouses. Highest priority was placed on the implementation and refinement of cost savings programs, most of which had been started in mid-1974 and have been successful.

Raw Materials

Management of the purchasing and inventory control of raw materials is a highly complex science, and

in 1975 Hershey again proved it has the capability and resources to manage its raw materials program in an orderly and productive manner.

Reduced cocoa bean grindings by manufacturers during 1975 helped to lower cocoa prices for the year, in comparison to 1974, though these prices remain at levels that are more than double the average prices experienced over the preceding ten years.

Sugar, after its spectacular price rise in 1974, receded through most of 1975.

Though almond production in 1975 was hampered by frost damage, prices remained relatively stable and actually declined slightly because of large carryovers from the year before.

Milk prices rose dramatically in the latter part of 1975, reflecting temporary shortages of supply versus demand in certain parts of the nation.

Regulatory Compliance

Faced with ever increasing regulatory activity at the federal, state and local levels, the Division has placed first priority on maintaining the highest quality and protection for the consumer. The Division is convinced that it is to its benefit to work cooperatively with the regulatory agencies in developing meaningful compliance programs which impact upon our industry and the Division.

Hershey Chocolate of Canada

In Canada, the Hershey organization coped with many of the problems similar to those experienced in the United States. Dollar sales recorded significant advances, much of which were the result of price increases introduced in 1974 and early 1975.

Canadian consumers demonstrated strong resistance to 20¢ bars, resulting in the continuation of the decline in industry-wide bar sales. Substantial gains in Hershey sales of packaged confectionery lines and grocery products (Instant, Baking Chips, Syrup, Cocoa) served to offset the weakness in bar sales.

Despite uncertain industry conditions and aggressive competition, the Canadian organization operated profitably for the first time in its history in 1975 and is looking to 1976 with cautious optimism despite the continued unsettled conditions in the marketplace.

Food Products and Food Services

	1975	1974
Sales (in millions)	$72.9	$72.8
% Change	+00.2	
Operating Income (in millions)	$ 3.5	$ 2.7
% Change	+33.2	

The figures above relate to continuing operations only; thus 1974 figures have been adjusted to eliminate the impact of Portion Control Industries, the divestiture of which is discussed elsewhere in this report.

San Giorgio Macaroni

The new management organization installed in early 1975 has made significant productivity gains in cooperation with employees at all plants. This performance has helped the subsidiary attain higher operating margins, which, in turn, raised operating income to record levels.

Hershey's brands, "San Giorgio" and "Delmonico" achieved higher sales volume in 1975 and together realized the largest market share increase of any pasta manufacturing company in the United States. Total sales volume, however, remained approximately equal with the previous year due primarily to lower selling prices plus reduced volume on private brand sales and institutional products.

The generally lower selling prices in the industry were brought about by intense competition and the reduced

San Giorgio spaghetti presses

San Giorgio/Delmonico warehouse

cost of semolina. Durum wheat prices receded to an average per bushel price of $6.03 versus a 1974 average of $7.56. This came about because of heavier plantings induced by 1974's higher prices and because of new strains of durum wheat being developed in the Southwest, primarily Arizona. While the U.S. manufacturers continue to use the long established durum wheat of North Dakota, the Arizona durum is being well received in the export market.

As commodity prices receded in 1975, the company engaged in extensive promotional programs to stimulate demand and maintain shelf position.

Major capital additions in 1975 included two new presses installed in our Lebanon plant. These are modern, high speed units, one for long cut product such as spaghetti, and one for short cut product such as macaroni.

San Giorgio continues to supply 10 major markets—Philadelphia, Pittsburgh, Baltimore-Washington, Columbus, Cincinnati, Louisville, Indianapolis, Richmond-Norfolk, Southern New Jersey, and Northern New Jersey. The company expects to enter several new markets in 1976.

Cory Food Services

Cory Food Services is primarily a service company. Generally, such companies have two primary attributes: (1) relatively low capital investment and better than average ability to generate cash; (2) a prime emphasis upon quality of management, especially at local levels. The year 1975 found Cory restructuring its management team and capabilities, strengthening a number of departments and locations with the addition of key managers, providing closer operational controls, and intensifying management training efforts. We believe major strides have been made, thus providing a capability for increased profitable growth in future years.

While sales and operating income at Cory were slightly under plan in 1975, operating income was higher than in the previous year.

The Coffee Services Division provides beverage services to offices in seven countries throughout the world.

Cory Coffee Service office installation

Cory production line at Chicago, Ill.

Cory's concept, it should be noted, has attracted numerous imitators and has actually developed into a new business idea.

While the business recession of 1975 resulted in some paring down by a number of Cory's customers, sales were near record levels for the division and operating income matched the previous year.

Heavy frosts in Brazil's coffee growing areas caused some distress among coffee roasters, packagers and coffee service companies alike, and prices of green coffee beans rose 50% within a few weeks in June and July. Thus, we increased prices late in 1975, but only to pass through our own higher costs, and volume dropped just slightly.

In 1976 there is additional concern regarding a continuation of the upward movement in green coffee prices. However, we remain optimistic about the future of this Cory-pioneered service industry.

For the Cory Products Division the future holds considerable promise in the light of the development of a new line of products featuring tankless coffee brewers and innovative heating units utilizing patents and principles of Therm Industries, a Cory subsidiary. Therm's new tankless brewers constitute a breakthrough in the industry. They offer less complicated, more trouble-free systems for the institutional market, and at lower cost. New in Cory's consumer line are a drip coffee brewer and range top glass drip brewers.

Development and Research

It is essential that Hershey strive continually to develop programs to improve the quality of its raw materials. As previously announced, the Company has an interest in Chadler Industrial da Bahia in Brazil, a firm which converts cocoa beans into chocolate liquor, cocoa butter, and cocoa powder. More recently Hershey has begun several cocoa growing ventures in Costa Rica and the Dominican Republic. Through these projects your Company hopes to be able to demonstrate that by the use of modern techniques productivity can be greatly im-

Quality assurance lab at Hershey, Pa.

proved and cocoa growing can be a more profitable operation. Hershey plans to expand this effort by joining in similar ventures with interested governments or private growers in several other countries. These will all be of limited size and will not supply any major portion of the Company's requirements. Your Company is also trying to foster the adoption of modern systems to improve the handling and shipment of cocoa beans from the farm to the factory. All of this is, of course, in addition to Hershey's continued support of the American Cocoa Research Institute, which for many years has encouraged and financially aided the expansion and improvement of the volume and quality of cocoa bean production in this hemisphere.

Hershey is further expanding its efforts in the area of research to provide new products and to improve the quality and safety of existing products. Research and development activity will be directed towards those consumer product areas that can be identified as having the greatest promise in terms of consumer acceptance and in terms of utilization of readily available ingredients. It will also relate to products that are closely identified with current lines as well as products that offer opportunity in new consumer markets.

In 1976 your Company will move forward with modernization of chocolate processing. Modern processing techniques will provide increased ability to control product quality and ingredient usage, while maintaining Hershey's unique texture and flavor. This modernization will boost productivity, and it will help to ensure continued regulatory compliance in the years ahead.

Employee Training and Motivation

In 1975 your Company initiated new training and motivational programs designed to more fully capitalize upon the capabilities and imagination of all employees. One such program, entitled Operations Improvement, is an effort to encourage employee participation in cost reduction and profit improvement activities as part of everyday routine. Another program uses workshops to refine working relationships among men and women at all job levels. Both these efforts reflect a determination on the part of the Company to use the talents of all employees to achieve higher levels of commitment and enthusiasm. Both programs will be expanded in 1976.

Management Changes

Coincident with the management changes as indicated in the Chairman's letter, Earl J. Spangler has been named to the position of President, Hershey Chocolate & Confectionery Division, effective March 1. Mr. Spangler joined the firm in 1950 and most recently served as Divisional Vice President-Manufacturing and Distribution.

Also effective March 1, two new corporate vice presidents have been elected—William F. Suhring, as Vice President, Corporate Development, and William P. Noyes, as Vice President, Human Resources. Mr. Suhring joined Hershey in 1968 and served most recently as Divisional Vice President-Marketing. Mr. Noyes has been with the Company since 1971, serving most recently as Corporate Director of Personnel.

Management's Discussion and Analysis of the Summary of Operations

The financial comments relate to the current two year comparative results of operations as well as the five year financial summaries contained on pages 12 and 20.

During the five years ended December 31, 1975, Hershey Foods Corporation experienced growth in consolidated net sales. Net income showed a continued upward trend except for 1973 when Federal price restrictions adversely affected earnings.

Sales—Consolidated net sales of continuing operations increased by $64,333,000 or 13.1% in 1975 compared with 1974. The Chocolate and Confectionery Division accounted for the increase in sales with the Food Products and Food Services remaining at approximately the same levels as 1974. The Pasta Division did, however, achieve a better sales mix by selling proportionately more of the Company's brands, "San Giorgio" and "Delmonico," than private label brands. Cory sales in 1975 were approximately the same as those in 1974. Record sales were achieved in 1974.

Several general price increases were put into effect in 1974 for chocolate and confectionery products in an effort to offset rapid increases in costs, primarily those of raw materials. The Company decreased prices on a selected number of these products during 1975. Sales dollars increased substantially reflecting the higher average selling prices in 1975 compared with 1974. There was an increase in volume of consumer units in 1975 compared with 1974. The actual poundage sold in 1975 declined, however, as a result of lower average bar weights of many of the chocolate and confectionery items in 1975.

Expenses and Income—Federal price restrictions, which did not allow a timely pass-through of cost increases, adversely affected earnings in 1973.

The Company experienced unprecedented escalation in virtually all raw material costs beginning in 1973 and continuing through 1974 and into 1975. The most significant increases were incurred in sugar and cocoa beans for chocolate and confectionery products. Although market prices of cocoa beans and, particularly, sugar receded in 1975 compared with the highs of 1974, the Company's average annual costs of these commodities were higher in 1975 than in 1974. The significant cost increase for Food Products and Food Services was incurred for coffee. Cost of flour used in pasta products declined in 1975 compared with 1974.

A substantial portion of the Company's raw materials, goods in process and finished goods had for many years been stated at cost under the LIFO method. In 1974, the Company extended LIFO inventory accounting to sugar and certain packaging materials in its Chocolate and Confectionery Division in order to more realistically match costs against revenue and reduce the effect of inflation on earnings. The effect of the change was to increase cost of sales in 1974 by $12,444,000 and decrease net income by $6,002,000 or 46¢ per share. As a result of this extension of the LIFO method of valuing inventories, substantially all of the Chocolate and Confectionery Division inventories were valued under the LIFO method in 1974 and 1975.

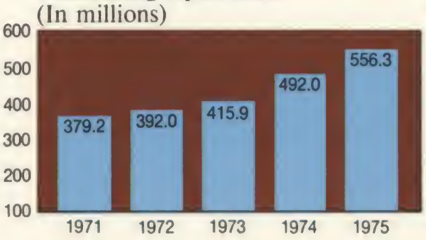
Selling, administrative and general expenses increased substantially in 1975 compared with 1974 because of increased promotion and selling expenses and the resumption of consumer advertising. Advertising was reduced in 1973 and virtually eliminated in 1974. In 1975 the advertising program was restored. Advertising costs were $9,325,000 in 1975 compared with $1,744,000 in 1974.

Interest expense declined in 1974 and again in 1975. This decline in interest expense reflects an improved cash position resulting from increased cash flow from improved earnings. In addition, inventory and receivable balances were reduced and interest rates declined in 1975.

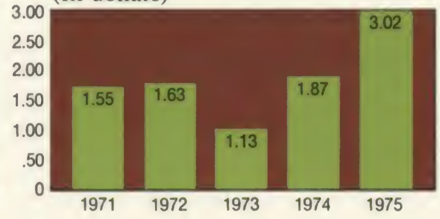
Income from continuing operations was $39,293,000 in 1975 compared with $24,371,000 in 1974 or an increase of 61.2%. After giving effect to losses from discontinued operations as well as the loss on disposal (see below), the net income in 1975 was $32,962,000 compared with $22,094,000 in 1974.

Discontinued Operations—The operations of one of the Company's subsidiaries, Portion Control Industries, Inc., were discontinued December 5, 1975. Portion Control Industries was a Chicago-based manufacturer of

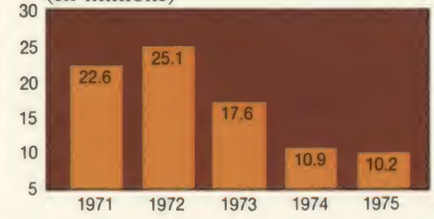
Net Sales From Continuing Operations
(In millions)



Income Per Share From Continuing Operations
(In dollars)



Capital Expenditures
(In millions)



frozen, prepared foods for the food service industry. The sales, operating expenses and loss are excluded from the results of continuing operations.

The losses from discontinued operations were $1,433,000 in 1975 and $2,277,000 in 1974. In addition, the loss on disposal of this business was $4,898,000.

Capital Additions—Capital additions in 1975 amounted to $10,203,000. Of this amount, depreciation provided $7,541,000. The Company spent $86,393,000 or an average of $17,279,000 annually for plant improvements during the past five years.

Revenue Bonds—On April 1, 1975, the sale of $4,000,000 of Industrial Development Revenue Bonds, having an interest rate of 6⅞% and due 2000 through 2005, was concluded. The funds are being used to finance certain pollution control and environmental capital expenditures.

Dividends—The Company completed its 46th year of uninterrupted dividends with the payment on December 15, 1975, of its 184th consecutive quarterly dividend on the common stock. Cash dividends of $10,287,948 were paid on the Company's capital stock in 1975 compared with $9,699,264 in 1974. Dividends in 1975 were 85¢ per share of common stock and 60¢ per share of preferred stock. The regular quarterly common stock dividend paid on December 15, 1975, was increased to 25¢ per share from the previous quarterly rate of 20¢ per share.

Sales and Income by Class of Products (dollars in thousands)

	1975		1974		1973		1972		1971	
	$	%	$	%	$	%	$	%	$	%
Net Sales From Continuing Operations										
Chocolate and Confectionery Products	**483,426**	**87**	419,225	85	351,016	84	335.042	85	308,884	81
Food Products and Food Services	**72,902**	**13**	72,770	15	64,928	16	56,962	15	70,345	19
Total	**556,328**	**100**	491,995	100	415,944	100	392,004	100	379,229	100
Income From Continuing Operations										
Chocolate and Confectionery Products	**80,032**	**96**	50,255	95	31,077	91	42,425	93	41,772	92
Food Products and Food Services	**3,549**	**4**	2,664	5	2,982	9	3,257	7	3,568	8
Operating Income	**83,581**	**100**	52,919	100	34,059	100	45,682	100	45,340	100
Interest, income taxes and certain general corporate expenses	**44,288**		28,548		19,384		24,360		24,891	
Income from continuing operations	**39,293**		24,371		14,675		21,322		20,449	
Losses from discontinued operations	**(1,433)**		(2,277)		(369)		(680)		44	
Loss related to disposal of discontinued operations	**(4,898)**		—		—		—		—	
Net Income	**32,962**		22,094		14,306		20,642		20,493	

Consolidated Statements of Income and Retained Earnings

	For the Years Ended December 31	
	1975	1974*
Net Sales	$556,328,095	$491,995,313
Costs and Expenses:		
Cost of goods sold	368,991,744	357,830,496
Selling, administrative & general	74,768,177	51,977,222
Shipping	22,793,906	21,901,814
Depreciation	7,540,608	7,912,403
Interest (Net)	1,258,858	2,190,392
Total costs and expenses	475,353,293	441,812,327
Income from continuing operations before taxes	80,974,802	50,182,986
Provision for Federal & state income taxes (Note 5)	41,682,000	25,812,000
Income from Continuing Operations	39,292,802	24,370,986
Discontinued Operations (Note 2):		
Losses from discontinued operations (less income tax benefits of $1,372,393 and $2,120,000)	(1,432,839)	(2,276,828)
Estimated loss related to disposal of discontinued operations (less applicable income tax benefits of $4,622,000)	(4,898,000)	—
Net Income	32,961,963	22,094,158
Retained Earnings at January 1 (Note 1)	163,109,776	150,714,882
Deduct—		
Transfer to common stock in connection with restatement to $1.00 per share (Note 1)	2,960,774	—
Dividends—Preferred	240,000	240,000
Common	10,047,948	9,459,264
Retained Earnings at December 31	$182,823,017	$163,109,776
Net Income per Common Share (Note 4):		
Continuing Operations	$3.02	$1.87
Discontinued Operations		
Losses from operations	(.11)	(.17)
Loss related to disposal	(.38)	—
Net Income	$2.53	$1.70
Cash Dividends per Common Share	$.85	$.80

*Restated to reflect discontinued operations (See Note 2).

The accompanying notes are an integral part of these statements.

Consolidated Balance Sheets

Assets

	December 31 1975	1974
Current Assets:		
Cash	$ 8,598,918	$ 8,608,713
Commercial paper and certificates of deposit	44,763,781	14,435,000
Accounts receivable (less allowances for doubtful accounts of $845,026 and $933,724)	24,724,158	29,230,491
Inventories (Note 1):		
Raw materials	32,527,283	38,252,984
Goods in process	5,711,386	4,685,771
Finished goods	30,877,977	28,958,658
	69,116,646	71,897,413
Net assets of discontinued operations at estimated realizable value (Note 2)	4,013,000	—
Total current assets	151,216,503	124,171,617
Property and Equipment, at cost:		
Land	4,599,845	4,824,912
Buildings	56,655,167	63,029,265
Equipment	129,019,045	130,463,695
	190,274,057	198,317,872
Less—accumulated depreciation	76,512,884	73,325,700
	113,761,173	124,992,172
Goodwill	17,800,742	17,812,802
Other Assets:		
Deferred almond ranch development expenses (Note 1)	5,175,507	5,520,541
Deferred coffee service location costs (Note 1)	2,260,147	2,907,621
Prepaid expenses and other deferred charges	2,813,046	2,903,476
Investments	2,701,759	2,929,976
Industrial Revenue Bond trust funds (Note 6)	2,659,417	—
	15,609,876	14,261,614
	$298,388,294	$281,238,205

The accompanying notes are an integral part of these balance sheets.

Liabilities and Stockholders' Equity

	December 31 1975	1974
Current Liabilities:		
Loans payable within one year	$ 270,609	$ 567,333
Accounts payable	23,498,197	37,175,975
Accrued liabilities	12,564,135	7,701,972
Income taxes payable	16,160,723	12,134,145
Total current liabilities	52,493,664	57,579,425
Long-Term Debt (Note 6)	29,856,204	31,729,993
Deferred Income Taxes	20,191,104	18,755,704
Stockholders' Equity (Notes 1, 3 and 4)		
Capital Stock		
Cumulative Preferred Stock— Authorized 2,000,000 shares; issued 400,000 convertible shares with dividend rate of $.60 per year	—	1,200,000
Common Stock— Authorized 20,000,000 shares; outstanding 13,024,305 and 11,824,081 shares	13,024,305	8,863,307
Retained Earnings	182,823,017	163,109,776
Total stockholders' equity	195,847,322	173,173,083
	$298,388,294	$281,238,205

The accompanying notes are an integral part of these balance sheets.

Consolidated Statements of Changes in Financial Position

	For the Years Ended December 31 1975	1974
Financial Resources Provided		
Continuing Operations:		
Net income	$39,292,802	$24,370,986
Depreciation	7,540,608	7,912,403
Deferred income taxes	1,787,970	2,328,722
Total provided from continuing operations	48,621,380	34,612,111
Discontinued Operations:		
Net loss	(6,330,839)	(2,276,828)
Depreciation	714,335	693,643
Deferred income taxes	(352,570)	(27,671)
Property and equipment held for disposal	12,637,513	—
Total provided (applied) from discontinued operations	6,668,439	(1,610,856)
Proceeds from Industrial Revenue Bonds	4,000,000	—
Other	1,636,334	1,711,789
Total resources provided	60,926,153	34,713,044
Financial Resources Applied		
Cash dividends	10,287,948	9,699,264
Capital expenditures	10,202,569	10,886,758
Reduction in long-term debt	5,873,789	19,740,409
Investments	(228,217)	1,444,089
Industrial Revenue Bond trust funds	2,659,417	—
Total resources applied	28,795,506	41,770,520
Increase (decrease) in working capital	$32,130,647	$(7,057,476)
Details of increase (decrease) in working capital		
Cash	$ (9,795)	$ 1,282,434
Commercial paper and certificates of deposit	30,328,781	14,435,000
Accounts receivable	(4,506,333)	1,904,779
Inventories	(2,780,767)	9,443,363
Net assets of discontinued operations at estimated realizable value	4,013,000	—
Loans payable within one year	296,724	287,130
Accounts payable	13,677,778	(24,298,920)
Accrued liabilities	(4,862,163)	425,495
Income taxes payable	(4,026,578)	(10,536,757)
Increase (decrease) in working capital	$32,130,647	$(7,057,476)

The accompanying notes are an integral part of these statements.

1. Summary of Significant Accounting Policies

The significant accounting policies followed by the Company, as summarized below, are in conformity with generally accepted accounting principles.

Principles of Consolidation — The accompanying consolidated financial statements include the accounts of the Company and its subsidiaries after elimination of intercompany accounts and transactions. The accounts and transactions of the Company's Canadian operations and foreign affiliates are translated in accordance with Financial Accounting Standards Board Statement No. 8. Charges and credits to income as a result of foreign currency translation are insignificant.

Inventories—Substantially all of the Chocolate and Confectionery Division inventories are valued under the "last-in, first-out" (LIFO) method. Such LIFO inventories amounted to approximately $47,241,000 in 1975 and $47,726,000 in 1974. The remaining inventories are stated at the lower of cost or market under the "first-in, first-out" or "average cost" method. Current cost exceeds LIFO cost by approximately $52,460,000 at December 31, 1975 and $64,972,000 at December 31, 1974.

Depreciation — The Company and its subsidiaries follow the policy of providing for depreciation of buildings and improvements over estimated lives ranging from 20 to 50 years and of machinery and equipment over estimated lives ranging from 3 to 25 years. The companies have employed primarily straight-line methods in determining the annual charge for depreciation.

Major renewals and betterments are capitalized. Maintenance, repairs and minor renewals are expensed as incurred.

Goodwill — The excess cost of investments over net assets of the businesses acquired is carried as Goodwill in the Consolidated Balance Sheets. It is the Company's policy to carry Goodwill arising prior to November 1, 1970 at cost until such time as there may be evidence of diminution in value or the term of existence of such value becomes limited. Goodwill arising after October 31, 1970 is being amortized over a period not exceeding 40 years.

Deferred Items—Deferred development expenses consist of soil and water conservation payments and other preoperating expenses relating to the development of almond ranches by L. D. Properties Corporation, a wholly-owned subsidiary of the Company. Commencing in 1973, the first year of a substantial commercial harvest, the deferred expenses are being amortized on a straight-line basis over 18 years, which is the estimated commercially productive life of the almond trees.

Deferred location costs consist of certain expenses associated with the development and installation of new coffee service locations of Cory, a wholly-owned subsidiary. These costs are being amortized over the life of the installation, but not to exceed four years.

Development and Promotion Expenses — The costs of research and development ($2,008,000 in 1975 and $1,856,000 in 1974) and advertising and promotion are expensed in the year incurred.

Income Taxes — Provision for Federal and state income taxes is based on income recorded in the financial statements. Deferred income taxes arise principally from the use of different methods of depreciation for tax and accounting purposes. The reduction in income taxes currently payable, resulting therefrom, is credited to deferred income taxes in the balance sheet. The provision for income taxes has been reduced by allowable investment tax credits.

Retirement Plan — The Company has a Retirement Plan covering substantially all employees. The total pension expense was $4,007,000 in 1975 and $3,149,000 in 1974. The Company's policy is to fund current service costs as incurred; virtually all past service liability has been funded.

The Pension Reform Act of 1974 required the Company to amend its pension plan to conform with certain provisions of the Act, which become effective in 1976. The Company believes that the increase in pension expense for 1976 resulting from this amendment will approximate $500,000, and the effect on unfunded vested benefits will not be significant.

Common Stock — On February 18, 1976, the Board of Directors approved a resolution to restate the value of common stock to $1.00 per share and adopted the policy of accounting for treasury shares as if retired. The reclassification of treasury shares has been reflected retroactively in the accompanying financial statements by a charge to Retained Earnings as of January 1, 1974 of $19,839,123.

2. Discontinued Operations

Effective December 5, 1975, the Company discontinued the operations of Portion Control Industries, Inc. a Chicago-based manufacturer of frozen, prepared foods for the food service industry. This subsidiary had been acquired in a pooling of interests in 1970 and had been operating at a loss for the past four years. The Company's investment in this subsidiary has been written down to the estimated realizable value of the assets.

The sales of this subsidiary ($11,947,000 in 1975 and $22,004,000 in 1974), together with applicable operating expenses, have been excluded from the consolidated results of continuing operations.

It is expected that disposal of all assets including plant and equipment will be completed during 1976.

3. Preferred Stock

The 400,000 shares of Cumulative Preferred Stock stated at $1,200,000 were converted at December 31, 1975 into 1,200,000 shares of common stock.

4. Net Income Per Share

Net income per common share has been computed based on the average shares of common stock and common stock equivalents outstanding during the period (13,024,275 in 1975 and 13,024,074 in 1974). The shares of Cumulative Preferred Stock have been included in the computation at their common equivalent of three shares of common for one share of preferred.

5. Income Taxes

The provision for income taxes from continuing operations exceeds taxes currently payable by $1,787,970 in 1975 and $2,328,722 in 1974, primarily because tax depreciation exceeds book depreciation as a result of using accelerated methods for tax purposes.

The following is a reconciliation of the provision for income taxes on continuing operations included in consolidated income and the amount computed by applying the Federal statutory rate to income before income taxes.

	1975		1974	
	Amount	%	Amount	%
Taxes computed at statutory rate	$38,867,905	48.0	$24,087,833	48.0
Increase (reductions) resulting from:				
State income taxes, net of Federal income tax benefit	3,283,280	4.1	2,091,440	4.1
Investment tax credit	(648,627)	(.8)	(559,875)	(1.1)
Other, net	179,442	.2	192,602	.4
Provision for income taxes	$41,682,000	51.5	$25,812,000	51.4

6. Current and Long-Term Debt

Long-term debt at December 31, 1975 and 1974 consisted of the following:

	1975	1974
	(dollars in thousands)	
7¼% Sinking Fund Debentures due 1997 with annual payments of $1,500,000 beginning in 1978	$30,000	$30,000
Less Debentures repurchased	(4,560)	—
Industrial Revenue Bonds due 2000 thru 2005 (interest at 6⅞%)	4,000	—
Various other loans, less current portion of $118,000 and $422,000	416	1,730
	$29,856	$31,730

As a result of seasonal working capital requirements, the Company maintained lines of credit with domestic banks of $21,500,000 in 1974 and reduced the amount to $20,000,000 in late 1975. In 1974, average borrowings were approximately $800,000, reaching a maximum of $1,200,000. The weighted average interest rate was 9¾%. There were no borrowings in 1975 under these lines. The Company had borrowings in 1974 and 1975 under a $45,000,000 revolving credit and term loan agreement which averaged approximately $8,800,000 and reached a maximum of $21,500,000 in 1974 and $4,448,000 and $19,000,000 respectively in 1975. The weighted average interest rate on these borrowings was 11¼% in 1974 and 7½% in 1975. No borrowings pursuant to these arrangements were outstanding at December 31, 1974 and 1975.

The revolving credit and term loan agreement is with two domestic banks and allows the Company to borrow up to $45,000,000. The outstanding balance at April 2, 1976, may be converted into a term loan with payment due in equal quarterly installments commencing July 2, 1976 and ending April 2, 1983. Interest rate is ¼ of 1% above prime until April 2, 1976 and

½ of 1% above prime thereafter. As part of the agreement, the Company must pay a commitment fee equal to ½ of 1% of the unused portion of the commitment. In addition, the agreement contains certain restrictive covenants. The most significant of such covenants requires the Company as of each year end to maintain an excess of current assets over current liabilities of not less than $45,000,000, not to permit funded debt (debt which is due in excess of one year) to exceed 66⅔% of net worth and not to permit the ratio of current assets to current liabilities to fall below 1.5 to 1.

While there were no formal compensating balance agreements under these credit arrangements, the Company has been expected to and has generally maintained average compensating balances of 15% to 20% of borrowings or generally not less than 10% of commitments.

Industrial Revenue Bonds in the amount of $4,000,000 were issued on April 1, 1975, by the Dauphin County Industrial Development Authority to provide financing for certain pollution control and environmental expenditures by the Company. The Company is solely responsible for payment of principal and interest. At December 31, 1975, the unexpended balance of these funds ($2,659,417) is held by a Trustee.

During 1975, the Company purchased $4,560,000 of its 7¼% Sinking Fund Debentures due 1997. The pre-tax gain of $490,200 due to the extinguishment of debt resulting from this purchase was credited to income. The Company intends that these bonds will be used to meet sinking fund obligations beginning in 1978.

7. Lease Commitments

The Company rents and leases office space, automobiles and equipment, the aggregate annual cost of which is less than 1% of net sales.

8. Management Incentive Plan

On April 14, 1975 the stockholders of the Company approved the adoption of a Management Incentive Plan. Persons eligible for participation in the Plan are employees of the Company and its subsidiaries who have substantial managerial or similar responsibilities. Upon achievement of performance goals, compensation awards are to be paid. The Plan provides that the total amount of award payments for any year (including cash and stock valued at the date of payment) shall not exceed 4% of Before-Tax Income in excess of 16% of Total Invested Capital (Stockholders' Equity plus Long-Term Debt plus Deferred Income Taxes). The amount charged to expense for cash payment in 1975 was $450,000.

To the Stockholders and Board of Directors of Hershey Foods Corporation:

We have examined the consolidated balance sheets of Hershey Foods Corporation (a Delaware corporation) and subsidiaries as of December 31, 1975 and 1974, and the consolidated statements of income and retained earnings and changes in financial position for the years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying consolidated financial statements present fairly the financial position of Hershey Foods Corporation and subsidiaries as of December 31, 1975 and 1974, and the results of their operations and changes in their financial position for the years then ended, in conformity with generally accepted accounting principles consistently applied during the periods.

ARTHUR ANDERSEN & CO.

New York, N.Y.
February 18, 1976

Five-Year Financial Summary Hershey Foods Corporation and Subsidiaries

(All dollar and share figures in thousands—except market price and per share statistics)

Summary of Earnings	1975	1974	1973	1972	1971
Continuing Operations					
Net Sales	$556,328	491,995	415,944	392,004	379,229
Cost of Goods Sold	$368,992	357,830	294,174	255,162	247,784
Operating Expenses	$105,102	81,792	88,318	91,595	86,439
Interest Expense (Net)	$ 1,259	2,190	4,848	3,246	2,610
Income Taxes	$ 41,682	25,812	13,929	20,679	21,947
Income from Continuing Operations	$ 39,293	24,371	14,675	21,322	20,449
Losses from Discontinued Operations	$ (1,433)	(2,277)	(369)	(680)	44
Loss Related to Disposal of Discontinued Operations	$ (4,898)	—	—	—	—
Net Income	$ 32,962	22,094	14,306	20,642	20,493
Net Income—Per Share of Common Stock					
Continuing Operations	$3.02	1.87	1.13	1.63	1.55
Discontinued Operations					
Losses from Operations	$(.11)	(.17)	(.03)	(.05)	—
Loss related to Disposal	$(.38)	—	—	—	—
Net Income	$2.53	1.70	1.10	1.58	1.55
Dividends per—Common Share	$ .85	.80	1.10	1.10	1.10
Preferred Share	$ .60	.60	.60	.60	.60
Average number of Common Shares and Equivalents Outstanding during the year	13,024	13,024	13,024	13,064	13,212
Per Cent of Net Income to Sales*	7.1%	5.0%	3.5%	5.4%	5.4%
Financial Statistics					
Capital Expenditures	$ 10,203	10,887	17,564	25,137	22,602
Depreciation*	$ 7,541	7,912	7,010	5,622	5,597
Advertising*	$ 9,325	1,744	9,565	13,954	10,506
Current Assets	$151,217	124,172	97,106	108,667	102,965
Current Liabilities	$ 52,494	57,579	23,456	29,789	44,486
Working Capital	$ 98,723	66,593	73,650	78,878	58,479
Current Ratio	2.9:1	2.2:1	4.1:1	3.6:1	2.3:1
Long-Term Debt	$ 29,856	31,730	51,470	51,364	26,533
Debt-to-Equity Per Cent	15%	18%	32%	32%	17%
Stockholders' Equity	$195,847	173,173	160,777	159,714	156,280
Stockholders' Data					
Outstanding Common Shares at Year-End	13,024	11,824	11,824	11,824	11,977
Market Price of Common Stock—					
At Year-End	$ 18⅝	9¾	12⅝	23⅞	28
Range During Year	$10⅛-20⅞	8½-15	12½-24¾	21⅛-28¾	26-31⅜
Number of Common Stockholders	19,279	19,362	19,095	17,980	18,346
Employees' Data					
Payrolls	$ 74,329	72,936	74,464	67,700	62,189
Number of Employees—Year-End	7,150	7,200	8,500	8,530	9,140

*Restated to reflect continuing operations only.

Zimmerman Mohler Dearden

Harold S. Mohler, 57, joined Hershey Foods as an industrial engineer in 1948 following service as a Navigator in the 15th Air Force during World War II and graduation from Lehigh University. He was promoted to Assistant to the President in 1957, Vice President in 1962, President in 1965, and Chairman of the Board and President in 1974. On March 1, 1976, he assumed the position of Chairman of the Board and Chairman of the Executive Committee. He has been a member of the Board of Directors since 1960.

William E. C. Dearden, 53, joined Hershey Foods as an assistant to the Chairman of the Board in 1957 following graduation from Albright College, service in the U.S. Navy during World War II and the Korean Conflict, and previous employment with Dun & Bradstreet, Inc., and Milton Hershey School. He was promoted to Products Manager in 1961, Director of Sales and Marketing in 1965, Vice President-Sales and Marketing in 1967, Group Vice President in 1971, and Vice Chairman and Chief Executive Officer on March 1, 1976. He has been a member of the Board of Directors since 1965.

Richard A. Zimmerman, 43, joined Hershey Foods as an administrative assistant in 1958 following graduation from The Pennsylvania State University, service in the U.S. Navy, and previous employment with the Harrisburg National Bank & Trust Company (now Commonwealth National Bank). He was promoted to Assistant to the President in 1965, Vice President in 1971, Group Vice President later in 1971, and President and Chief Operating Officer on March 1, 1976. He has been a member of the Board of Directors since 1970.

Annual Meeting

The Annual Meeting will be held at 2 p.m. on Monday, April 12, 1976, at the Hershey Motor Lodge and Convention Center, Route 322 and University Drive, in Hershey.

A formal notice of this meeting, together with a proxy statement, will be mailed to stockholders on or about March 12, 1976.

Stockholders who are unable to attend the meeting are urged to sign and return their proxies promptly so the stock of the Company will be represented as fully as possible at the meeting.

Form 10-K

The Annual Report to the Securities and Exchange Commission on Form 10-K is available upon written request to the Secretary of the Corporation.

Principal Securities Market
The common stock is listed on the New York Stock Exchange.

Executive Offices
19 East Chocolate Avenue
Hershey, Pa. 17033

Transfer Agent and Registrar
First National City Bank
New York

Auditors
Arthur Andersen & Co.
New York

Board of Directors

H. S. Mohler, *Chairman*

W. E. C. Dearden

J. Hemphill
Director of Cocoa Bean Purchases and Assistant Treasurer, Hershey Foods Corporation

J. C. Jamison
Investment banker, Partner, Goldman, Sachs & Co., New York, N. Y.

S. A. Schreckengaust, Jr.
attorney at law, Executive Partner, McNees, Wallace & Nurick, Harrisburg, Pa.

L. C. Smith

R. L. Uhrich

R. A. Zimmerman

Officers

H. S. Mohler
Chairman of the Board

W. E. C. Dearden
Vice Chairman and Chief Executive Officer

R. A. Zimmerman
President and Chief Operating Officer

J. S. Harkins
Vice President, Finance and Administration

O. C. Johnson
Vice President, Scientific Affairs

L. C. Smith
Vice President, Engineering

R. L. Uhrich
Vice President and Secretary

W. F. Suhring
Vice President, Corporate Development

W. P. Noyes
Vice President, Human Resources

L. W. Simmons
Treasurer and Comptroller

Hershey Foods Corporation
Hershey, Pa. 17033, U.S.A

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